2019 Q2 REVIEW Q3 PREVIEW

Q2 REVIEW:

As we cross the halfway line for 2019, we look back and review our forecasts coming into January this year. As a recap, per our 2019 Q1 Preview note (published on 8 January 2019), we forecasted a year-end 2019 S&P target price of 2,930 (the S&P 500 was trading at 2,525 at the time). Within equities, we recommended exposure to cyclical sectors (technology, industrials and consumer discretionary), while avoiding defensive sectors (utilities, consumer staples and healthcare). We also indicated a preference for domestic US stocks over international exposure. In terms of fixed-income allocations, we suggested investing in the sub 2-year part of the yield curve.

So how are we doing?

EQUITIES:

The S&P 500 closed out Q2 at 2,941 (11 points above our fair value target), while an equal-weighted cyclical basket (tech, industrial and consumer discretionary sectors) would have returned 23.45% versus a 12.98% return for the defensive basket (utilities, consumer staples and healthcare). The US market beat international indices with the S&P 500 returning 18.54% for H1 vs 14.06% for the S&P Developed ex-US index, and 12.06% for the S&P Emerging Markets index.

The quarter can be summarized by distinct market themes each month. Equity markets drifted higher in April on hopes that a trade deal would be reached between the US and China. In May, equities sold off as the US announced trade negotiations had stalled. June was marked by a rebound in equities, after the Federal Reserve signaled they may be open to cutting interest rates to sustain economic growth.

FIXED INCOME:

We unfortunately did not fair so well with our call within the fixed income space. We expected global rates to rise as the US Federal Reserve and European Central Bank dialed back their quantitative easing programs and reduced their balance sheets. Additionally, we expected more US Treasury supply (to fund the rising fiscal deficit) to also lift rates higher. Our target on the 10-year Treasury was 3.25% by year-end.

Using ticker symbol SHY as a proxy for our sub 2-year allocation recommendation, the H1 return was 2.34% vs 5.80% for ticker AGG.

Like equities, fixed income markets can be summarized by monthly market themes for the quarter. Bonds sold off in April on prospects of heightened growth around hopes of a trade deal. May saw yields lower as the trade deal was called off and global economic data showed signs of weakness. June saw a continuation in the bond rally as the market priced in Fed rate cuts later this year.

Q3 PREVIEW:

As we look at rolling 12-month forward earnings estimates, we have upgraded our year-end S&P 500 fair value target marginally to 2,960 (from 2,930 in January). The S&P 500 is trading at a level of 2,990 at the time of writing, making the market roughly 1% overvalued versus our target. We believe progress around trade talks will be very slow, as US politicians turn their attention to domestic electioneering. With geopolitics taking a backseat, investor focus will return to fundamentals, i.e. corporate profitability (Q2 earnings reporting season starts in mid-July), economic data, and the Federal Reserve's moves on interest rates (25bp cut priced in currently for July meeting).

CONCLUSION:

Given our forecast of virtually zero upside in equities, we suggest taking a more defensive approach to equities, either by switching to lower beta / higher quality equities and sectors (excluding utilities and REITs), taking advantage of the low volatility currently to buy hedges to protect this year's gains, or changing asset allocations from equities to a higher weighting in bonds. With six months remaining in the year, we stick with our forecast that fixed income allocations should target the sub 2-year part of the yield curve as the safest place to protect wealth within the space.

*All returns data per S&P Dow Jones Indices

WEEK AHEAD:

As we return to a full week of trading, given Friday's strong jobs data, market participants will search for further clues regarding the extent of the July rate cut later this month. Several Federal Reserve Committee members speak throughout the week, with particular focus on Fed Chair Powell's semiannual monetary report to Congress, and the publication of the June FOMC minutes. Other important economic releases include consumer and producer price inflation figures.

Quarterly earnings reports from PepsiCo (PEP), Bed Bath & Beyond (BBBY), Delta Airlines (DAL) and Fastenal (FAST) are due.

Our tactical model remains bullish (100% equity invested).

GAUGE OF THE GRADE

BEARISH NEUTRAL BULLISH

SECTOR RETURNS					
	5 DAYS	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS
Basic Materials	0.5	5.5	1.2	15.4	-0.5
Communication Services	2.8	7.4	3.7	16.0	4.2
Consumer Cyclical	2.0	7.2	3.1	19.7	9.0
Consumer Defensive	2.2	3.9	6.4	16.1	14.8
Energy	-0.9	5.9	-7.2	5.7	-16.5
Financial Services	2.0	4.5	6.1	17.3	6.6
Healthcare	1.1	5.3	2.1	11.4	10.7
Industrials	0.2	4.0	1.9	20.8	8.7
Real Estate	2.5	2.2	3.0	22.6	13.2
Technology	2.3	8.3	5.3	31.1	19.0
Utilities	1.6	1.7	5.2	16.6	18.2

MONDAY JULY 8, 2019
Consumer Inflation Exepctations
Consumer Credit Change
TUESDAY JULY 9, 2019
NFIB Business Optimism Index
Fed Chair Powell Speech
Redbook
JOLTs Job Openings
WEDNESDAY JULY 10, 2019
MBA Mortgage Applications
Fed Chair Powell Testimony
Wholesale Inventories
FOMC Minutes
THURSDAY JULY 11, 2019
Consumer Price Inflation
Initial Jobless Claims
Fed Chair Powell Testimony
WASDE Report
Monthly Budget Statement
FRIDAY JULY 12, 2019
Produce Price Inflation